ORIGINAL

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
KMC Telecom Inc. Petition For Declaratory Ruling	)	CC Docket No. 99-142
	)	
	)	

COMMENTS

BELLSOUTH CORPORATION
BELLSOUTH TELECOMMUNICATIONS, INC.

M. Robert Sutherland
Richard M. Sbaratta

Their Attorneys

BellSouth Corporation
Suite 1700
1155 Peachtree Street, N. E.
Atlanta, Georgia 30309-3610
(404) 249-3386

Date: June 3, 1999

TABLE OF CONTENTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
KMC Telecom Inc. Petition For Declaratory Ruling	)	CC Docket No. 99-142
	)	
	)	

COMMENTS

BellSouth Corporation and BellSouth Telecommunications, Inc. ("BellSouth") hereby submit their Comments on KMC Telecom Inc.'s ("KMC") petition for declaratory ruling.

I. INTRODUCTION AND SUMMARY

On April 26, 1999, KMC filed its petition for declaratory ruling and requested the Commission to: (1) declare that termination liabilities imposed by incumbent local exchange carriers ("ILECs") are unlawful; (2) prohibit the enforcement of termination liabilities by ILECs; and (3) require the removal of ILEC termination liabilities from state tariffs. The unequivocal purpose of KMC petition is to cause the Commission, under the guise of Section 253, to preempt state tariff provisions. Not only does Section 253 not provide the Commission with the authority to take the action that KMC requests, but also, the relief requested by KMC is far more draconian than that which the Commission has ever determined to be necessary or appropriate in the interstate jurisdiction.

KMC argues a misguided view that the "fresh look" relief it seeks is necessary to give effect to the purpose and goal of the Telecommunications Act of 1996 (the "Act"). KMC confuses steps that promote competition with those that promote individual competitors. The Act's purpose of opening all telecommunications markets to competition does not equate, however, to advancing the interests of one group of competitors over that of another. If there has been a single certainty since the passage of the Act, it has been that the Commission has steadfastly held to the principle of competitive neutrality in implementing the Act.[1] KMC's requested relief is neither competitively neutral nor would it constitute sound public policy.

There simply is no nexus between the competitive ills of term plans alleged by KMC and the broad sweeping relief of abrogating all state contracts and tariffs. Neither this Commission nor any state commission has found the existence of term plans and their associated termination liabilities *per se* unreasonable and anticompetitive. Yet, such a result is precisely the relief that KMC seeks in its petition. KMC offers no facts to bolster its claims other than anecdotal recitations that termination liabilities exist. Such recitations hardly constitute the type of requisite factual demonstration that could substantiate Commission action—assuming the Commission had authority to act on KMC's request.

KMC's petition is jurisdictionally infirm. The relief that it requests, preemption by the Commission, can only be granted under Section 253 of the Communications Act.[2] Section 253, however, is confined to state actions that prohibit entry into the telecommunications market. KMC's petition has nothing to do with market entry—to the contrary, its focus is on the degree of success it will have and how its success would be enhanced if it were given a regulatory boost. Accordingly, Section 253 provides no basis for Commission action. Indeed, were the

---

1 *See, e.g.,* In the Matter of Telephone Number Portability, CC Docket No. 95-116, *Third Report and Order*, 13 FCC Rcd 11701 (1998); In the Matter of Federal-State Joint Board on Universal Service and AMSC Subsidiary Corporation Request for Waiver, CC Docket No. 96-45, *Memorandum Opinion and Order*, 13 FCC Rcd 22426 (1998) (The Commission denied AMSC's petition for waiver because it did not meet the competitive neutrality standard under the Act.)

2 47 U.S.C. § 253.

Commission to try to force states into abrogating existing contractual relationships, such state action would be constitutionally infirm.

The massive market intervention sought by KMC simply has no place in a competitive market. The fact is that the market segment that KMC addresses in its petition, the large business user, has had the benefit of competitive alternatives for many years. Contracts and term plans are the natural evolution of the competitive process. The last thing that the Commission should do is to interfere with that process.

II. DISCUSSION

A. Section 253 Does Not Authorize The Commission To Preempt State Tariffs And Contracts

KMC's request that the Commission preempt state tariffs, declare all termination liabilities in such tariffs unlawful and require state commissions to afford all ILEC's intrastate customers a fresh-look goes beyond the authority given to the Commission under Section 253 of the Communications Act.[3] Section 253 is a narrowly tailored provision:

> No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.[4]

The provision is explicitly directed to a state statute, regulation or requirement that prohibits entry by a carrier or prevents a carrier from providing a telecommunications service. There is no state statute, regulation or requirement that precludes KMC from entering the local market or from providing any telecommunications service.

The substance of KMC's petition concerns, not KMC's legal ability to enter the marketplace, but rather the degree of success that KMC may achieve. Its request amounts to

---

3 47 U.S.C. § 253.

4 47 U.S.C. § 253(a).

little more than seeking the Commission's assistance to advance its business interests. KMC would have the Commission vitiate the business relationships ILECs have legitimately established with their customers. Section 253 of the Act, however, does not empower the Commission to do so.

Section 253 is intended to remedy the specific situation in which a state acts so as to preclude an entity from entering the market or providing a telecommunications service. No such act has occurred here. There is nothing in the express language of Section 253 or its legislative history to suggest that Congress anticipated that the Commission would have to interject itself in the business relationships between carriers and customers in order to fulfill its statutory obligations. Indeed, Congress wisely avoided embroiling the Commission in such issues and the constitutional morass that would be engendered if the Commission sought to require states to impose a fresh look requirement.

For the Commission to direct state commissions to abrogate existing contractual relationships between ILECs and their customers would require state action that violates the Contract Clause of the U. S. Constitution. The Contract Clause provides that "No State shall...pass any...Law impairing the Obligation of Contracts..."[5] This prohibition has been interpreted to mean that no state may take legislative or administrative action that substantially impairs a contractual obligation, unless such action is justified as reasonable and necessary to achieve an important public purpose.[6] State action is especially egregious—in a constitutional sense—when, as here, it impairs the contracts of a narrow class of persons in order to meet its

---

5 U.S. Const. art. I, § 10, cl. 1. Many state constitutions have similar provisions. *See e.g.*, Tenn. Const. art. I, § 20 ("That no retrospective law, or law impairing the obligations of contracts, shall be made"); Fla. Const. art. I, § 10.

6 *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25 (1977).

desired purpose.[7] Accordingly, a careful examination of the nature and purpose of the State action is necessary.[8]

As the Supreme Court has observed, "[i]f the Contract Clause is to retain any meaning at all, however, it must be understood to impose some limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power."[9] Thus, it is not a question of whether a state can abridge private contractual rights, but rather, if it so acts, whether such action is within constitutional limits.

Resolution of this question involves a tripartite analysis.[10] The initial inquiry is whether state action has operated to substantially impair a contractual relationship. If so, the state must have a substantial and significant legitimate public purpose in taking such action. Finally, the adjustment to the rights and responsibilities of the contracting parties must be based upon reasonable conditions and must be of a character appropriate to the public purpose justifying the state action.[11]

Here, there can be no question that the fresh look requested by KMC would result in a total impairment of the contracts in question, and, hence, the "substantial impairment" component of the tripartite analysis is readily established. Given that a fresh look will operate as a substantial impairment of ILEC/customer contracts, the state or state commission must have a significant and legitimate public purpose justifying its actions. As the Supreme Court has observed, "[t]he requirement of a legitimate public purpose guarantees that the State is exercising

---

7 *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 248 (1978).

8 *Id.* at 244.

9 *Id.* at 242.

10 *Energy Reserves Group. Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 410-13 (1983).

11 *Id.*

it police power, rather than providing a benefit to special interests."[12] No such public purpose exists here.

KMC attempts to justify the need to abrogate these private contracts on the basis of a need to stimulate competition in the local exchange market. Even assuming that this were a sufficiently significant and legitimate public purpose, or that such a public purpose were not already being satisfied by state statutory and regulatory provisions, a close examination of KMC's fresh look proposal reveals that its purpose is private not public. The sole purpose behind the fresh look is to destroy existing contractual relationships so that competitors of ILECs can take the ILEC's largest customers and commit them to extended contracts of their own. Under the guise of fresh look, the states are supposed to use their police power to undo the results of a contractual bargain, which itself was the product of a competitive process, so that an ILEC's competitors can cherry pick the largest and most lucrative ILEC customers. Such an action serves only to benefit ILEC competitors—not the public.

Finally, and assuming some significant and legitimate public purpose could be found to justify a fresh look requirement—and it cannot—"the next inquiry is whether the adjustment of the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption."[13] Imposition of a fresh look cannot be characterized as either "reasonable" or "appropriate." A fresh look destroys contracts that are *prima facie* just and reasonable and that stimulate competition in what is already the most competitive segment of the local exchange market. It is neither "reasonable" nor "appropriate" to interfere with or nullify competition in the name of

---

12 *Id.* at 412.

13 *Id.* (quoting *US Trust*, 431 U.S. at 22).

trying to promote it.

In addition, imposition of a fresh look by the state would constitute an unconstitutional taking of property without just compensation.[14] A taking can occur as to an intangible property interest.[15] Contract rights are a form of property and as such may be taken for a public purpose only if just compensation is paid.[16] Accordingly, the valid contracts entered into by the ILECs with their customers are property rights protected by the Taking Clause of the Fifth Amendment.

There can be no question that abrogation of ILECs' existing contracts under fresh look would constitute a "taking."[17] Fresh look would: (1) deprive ILECs of the benefit of their economic bargain; (2) inflict additional economic losses in the future as valuable customers enter into extended contracts with competitors; and (3) impose additional regulatory burdens and expenses on ILECs that are unnecessary, unfair and at a cost that was not contemplated at the time the contracts were negotiated and for which no recovery can be made.

Further, a taking of ILEC property is impermissible unless the confiscated property is used for a public purpose.[18] As discussed above, abrogation of ILEC contracts has no legitimate public purpose. The taking of ILECs' property solely for the benefit of a few competitors produces a private, rather than a public, benefit. Even if a public benefit were to exist—which it

---

14 The Fifth Amendment to the United States Constitution provides that "private property [shall not] be taken for public use, without just compensation." U.S. Const. amend. V.

15 *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003-04 (1984).

16 *U.S. Trust*, 431 U.S. at 19, n. 16.

17 The contracts are the embodiment of ILECs' investment-backed expectations; they are bargained-for rights and obligations of ILECs with respect to their customers. They are also the means by which ILECs can legitimately protect their relationships with these customers, which represents a property interest that is constitutionally protected. *Ruckelshaus* at 1011 (holding that a corporation had a reasonable investment-backed expectation with respect to its control over the use and dissemination of its trade secrets, and once same are disclosed to others the corporation has lost its property interest in the data).

18 The public use requirement of the Taking Clause is "coterminous with the scope of the sovereign's police power." *Hawaii Housing Authority v. Midkiff*, 467 U.S. 229, 240 (1984).

does not—the ILECs would bear the entire burden of a fresh look and receive no compensation for the taking of their private property. Accordingly, imposition of a fresh look requirement would result in an unconstitutional taking of property.

These constitutional conundrums only arise if the Commission were to engage in a broad and expansive reading of Section 253. Such a statutory construction, however, is unwarranted. Unlike some other parts of the Act, Section 253 is not cloaked in a veil of ambiguity. Thus, the Commission must give effect to the plain meaning of the statutory provision. In so doing, the Commission must find the subject of KMC's petition outside the scope of Section 253 and deny KMC's request.

B. Even Assuming Section 253 Was Applicable, KMC Has Failed To Demonstrate A Basis For A Fresh Look

Even assuming that Section 253 prohibition against the states erecting entry barriers encompassed termination liabilities in intrastate tariffs and contracts—which it does not—KMC would have to produce evidence that such termination liabilities have effectively denied it entry into specific geographic and product markets. A mere perusal of KMC's petition shows that it is severely lacking. It is nothing more than anecdotal recitations of examples where customers have bargained for discounted rates and, as part of that bargain, have agreed to continue the service for a specified term or pay a termination liability.

Limiting its petition to a series of anecdotes enables KMC to present unsupported contentions as if they were fact. For example, KMC argues that customers are unaware of the termination liability when they obtain service.[19] This assertion is not correct. Termination liabilities are not hidden charges. They are clearly delineated in the applicable tariffs. For the

[19] Petition at 2.

types of tariffed services at issue, the customers are familiar with the operation of the tariff and, as in the interstate jurisdiction, are charged as a matter of law with knowledge of the tariff's contents. With respect to Contract Service Arrangements ("CSAs"), customers expressly agree in writing to the termination liability which is an integral part of the financial incentives and consideration for the parties to bind themselves to the terms and conditions set forth in the CSA.

KMC attempts to buttress its specious argument by contending that customers for these term plans lack bargaining power.[20] For the services at issue, the customer base consists of large telecommunications users, including major corporations and state governments. These users are sophisticated and well-versed regarding telecommunications in general and the procurement of services. The "take it or leave it" scenario that KMC attempts to portray simply does not lie down with the marketplace realities.

Contrary to KMC's apparent belief, large business customers have had alternatives to ILEC provided services for a considerable time. From the time of divestiture, it was recognized that these customers could avail themselves of bypass technologies and avoid the use local exchange facilities and services. Since then, the number of alternatives has continued to expand. KMC's blanket claim that " if a customer had alternatives in service providers, the customer would most likely not have agreed to such excessive, punitive termination penalty" lacks substance.[21] KMC references two examples that supposedly support its point. First KMC refers to a CSA for primary rate ISDN in North Carolina. KMC ignores the fact that state commissions have conditioned BellSouth's authority to offer CSAs on the existence of competitive

20 Petition at 3.

21 Petition at 4.

alternatives.[22] Thus, before BellSouth can offer a specific customer a CSA, that customer must have a competitive alternative to BellSouth's service available. Indeed, many of BellSouth's CSA's contain an express acknowledgement by the customer of such a competitive alternative.

CSAs are a valid response to competition. For example, local competition was authorized in Tennessee by state law in June 1995. Of the 165 BellSouth CSAs approved by the Tennessee Regulatory Authority through December 1998, more than ninety percent were approved in 1997 and 1998, two to three years after local competition was authorized.

KMC's other "showing" of the "practical effect" of termination liabilities is merely quoting a termination provision in BellSouth's private line tariff in Florida associated with a payment plan for SMARTRing service. KMC makes no mention of the fact that private line competition in Florida long preceded the Telecommunications Act of 1996. It is neither nascent nor in need of regulatory nurturing. Like the interstate transport market, competition is robust, particularly for high capacity ring services such as SMARTRing service. Like payment plans that exist in the interstate jurisdiction, state tariffs contain termination provisions associated with payment plans that provide discounts in consideration of a customer's commitment to a term plan.

KMC's petition is predicated upon the flawed premise that all termination liabilities are anticompetitive and unlawful. No regulatory agency, including this Commission, has ever made such a determination. To the contrary, as this Commission has found that term plans with their associated termination provisions "can be a useful and legitimate means of pricing...to recognize

---

22 Regulators have recognized CSAs as BellSouth's response to a competitive marketplace. *See, e.g.,* Tennessee Regulatory Authority's Report to the Tennessee General Assembly on the Status on Telecommunications Competition in Tennessee, 1995-1997, at 17 (June 5, 1997).

the efficiencies associated with larger volumes of traffic and the certainty of longer term deals."[23] They enhance consumer welfare by increasing choice and reducing cost.

KMC's claim that, because of term plans, "CLECs effectively have few customers to provide their services to and, thus, cannot enter the market" is bogus.[24] KMC has not even attempted to introduce any credible evidence that BellSouth's CSAs or the termination liabilities in any of its term plans have in any way inhibited competitive entry in BellSouth's markets.[25] In stark contrast to KMC's fiction is the reality that competitors are serving approximately 1 million access lines throughout BellSouth's region.

Before the Commission can act under Section 253, it must demand specific factual demonstrations that an entity has been prevented from entering a market. Absent such showings, the Commission could not possibly exercise the preemption authority provided in Section 253(d). Section 253(d) limits the Commission's preemption authority "to the extent necessary to correct" any inconsistency with the provision's requirements. The essential factual predicate necessary for the Commission to act in the circumscribed manner required by the statute is totally lacking in KMC's petition.

III. CONCLUSION

The Commission should deny KMC's petition. First, the Commission has no authority under Section 253 to grant KMC's request. Next, even assuming that Section 253 could to the circumstances described in KMC's petition, KMC has failed to present the requisite facts

---

23 In the Matter of Expanded Interconnection with Local Telephone Company Facilities and Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket Nos. 91-141 and 92-222, *Report and Order and Notice of Proposed Rulemaking*, 7 FCC Rcd 7369, 7463 (1992).

24 Petition at 9.

25 Indeed, such a showing would be especially difficult given that all of BellSouth's CSAs are subject to resale.

necessary for the Commission (1) to find that KMC is effectively precluded from entering specific geographic and product markets and (2) to craft a preemption order that meets the statutory requirement that the preemption be limited to the extent necessary to remedy the specific statutory violation. Further, denying KMC's petition will allow the Commission to avoid the constitutional conundrum that would occur if the Commission interpreted Section 253 to allow the abrogation of private contracts and to shift the benefit of those contracts to an ILEC competitor.

Respectfully submitted,

BELLSOUTH CORPORATION
BELLSOUTH TELECOMMUNICATIONS

By: ______________________

M. Robert Sutherland
Richard M. Sbaratta

Their Attorneys

BellSouth Corporation
Suite 1700
1155 Peachtree Street, N. E.
Atlanta, Georgia 30309-3610
(404) 249-3386

Date: June 3, 1999

CERTIFICATE OF SERVICE

I do hereby certify that I have this 3rd day of June 1999 served the following parties to this action with a copy of the foregoing COMMENTS by hand deliver or by placing a true and correct copy of the same in the United States Mail, postage prepaid, addressed to the parties listed below.

*Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals, 445 Twelfth Street, S. W.
Room TW-A325
Washington, D. C. 20554

Patrick Donovan
Kathleen L. Greenan
KMC Telecom Inc.
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N. W.
Suite 300
Washington, DC 20007

*International Transcription Service
1231 20th Street, N. W.
Washington, D. C. 20036

Juanita H. Lee
Juanita H. Lee

* **VIA HAND DELIVERY**